

# Assessing Risk of Agribusiness



August 20, 2013

# Proposed agenda

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## ❖ Objectives

- Present the audience with Finterra 's tools to assess credit risk of the agribusiness, small and medium size enterprises, within our target market.
- ❖ How does Finterra look at the investment opportunities for our clientele and how do we match our services with our clients' objectives
- ❖ Present the tools that Finterra uses to asses:
  - Character
  - Capacity
  - Capital
  - Collateral
  - Conditions

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**1. Finterra in brief**

**2. How does Finterra look at investment opportunities**

**3. General credit policies**

**4. Risk assessment**

**5. Conclusions**

# Finterra´s history

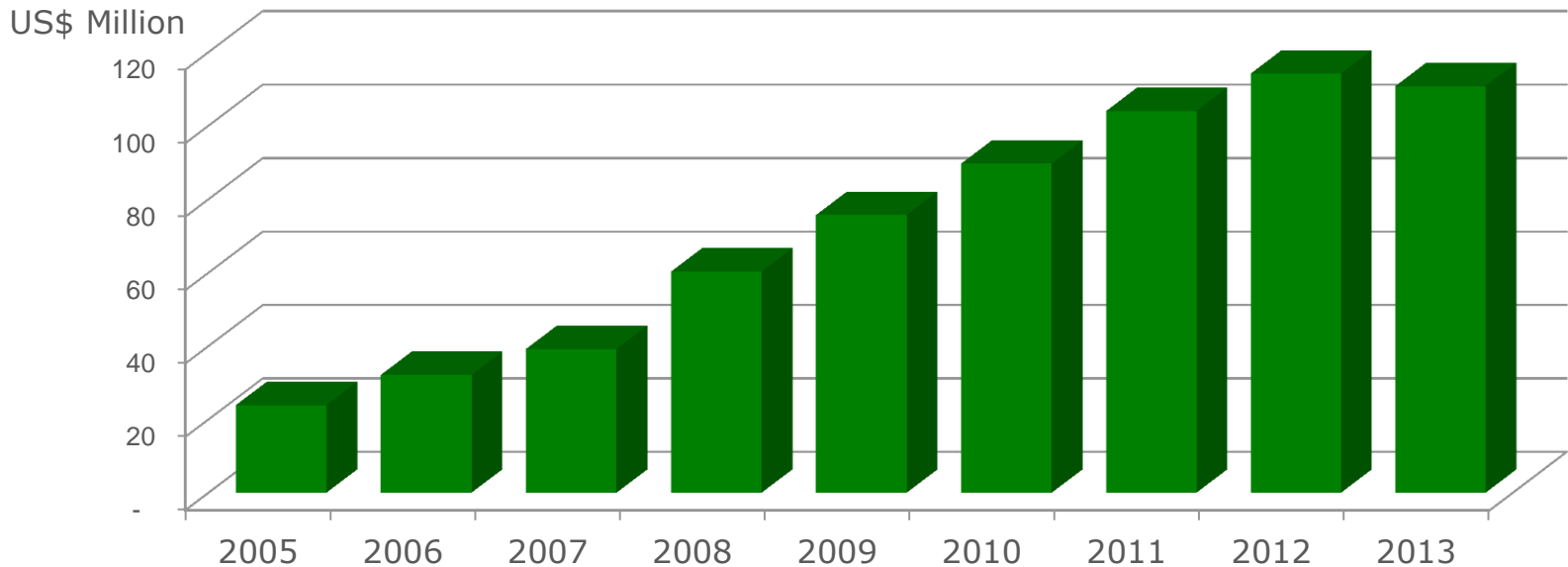
- ❖ Finterra, a SOFOM, created in June 2003, was the second non-bank bank dedicated to agribusiness in Mexico, initiated operations in September 2004.
  - The name “SOFOM” means: Financial Society for Multiple Purposes.
- ❖ We operate only in Mexico, focused in Agribusiness, on small and medium size growers, farmers, ranchers and trade companies.
- ❖ Our sources of funding:
  - FIRA, Bank of Mexico´s (Central Bank) Development Bank for Agriculture
  - International Finance Corporation (IFC)
  - DEG: Deutsche Investitions - und Entwicklungsgesellschaft mbH (German Investment and Development Company)
  - Multilateral Investment Fund (MIF) of the Interamerican Development Bank
  - Rabobank (Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.)
  - Proparco (French Development Bank)

# Finterra´s history

❖ Finterra has grown since its very beginning:

	Offices	Rel. Managers
2004	4	4
2005	8	13
2006	11	18
2007	13	24
2008	11	29
2013	18	39

❖ Our credit portfolio (US\$ as of March 31, 2013):



# Our offices in Mexico



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# Investment opportunities

- ❖ Mexico is a large country, and, agriculturally spoken offers:
  - ✓ Two growing cycles:
    - Spring (central and south), mostly rain fed
    - Winter (northwest, southwest and central north), irrigated
  - ✓ Coastal irrigated lands (below 900 meters Above sea level)
    - Corn, vegetables, tropical fruits and cattle breeding
    - Water management associations
  - ✓ Upland (900 – 2200 meters above sea level)
    - Coffee, corn, dairy, avocado, high quality fruits and vegetables
  - ✓ Large food industry: packers, processors, value added industries
  - ✓ Along the country
    - Distributors of agri input products
    - Agri crop Traders/Elevators
    - Farm machinery, irrigation systems, technology sellers



# Investment opportunities

	Sales Range (US\$)	# Farmers	Average Loan Size	Financing Needs (US\$ Millions)	Service Model
Micro Farmers	< \$ 20,000	4,445,202	\$1,597	\$7,098	Non Target Market
Small Farmers	\$ 20,000 - \$ 50,000	372,520	\$10,621	\$3,957	Products & Programs
Medium Farmers	\$ 50,000 - \$ 250,000	26,767	\$80,503	\$2,155	Individual Loans
Large Farmers	> \$ 250,000	5,680	\$860,327	\$4,886	Individual Loans
<b>Total Market</b>		<b>4,850,469</b>	<b>\$3,731</b>	<b>18,096</b>	
<b>FinTerra Target Market</b>		<b>373,126</b>	<b>\$29,572</b>	<b>\$11,034</b>	
Micro (Sugar Cane)		99,001	\$4,470	\$443	
Small		241,678	\$14,690	\$3,550	
Medium & Large		32,447	\$217,009	\$7,041	

# Investment opportunities

## ❖ Total market:

(US\$ million)	# Farmers	Production Value	Working Capital Financing Needs
<b>AGRICULTURE</b>			
Grains	3,264,167	9,896	5,201
Fruits & Vegetables	307,359	6,049	2,249
Sugar Cane	142,080	2,699	859
<b>LIVESTOCK</b>			
Animal Protein	877,088	19,558	7,996
Dairy	259,475	4,194	1,791
<b>TOTAL</b>	<b>4,850,169</b>	<b>\$42,396</b>	<b>\$18,096</b>

## ❖ Finterra target market, Primary sector only

(US\$ million)	Farmers	Production Value	Working Capital Financing Needs
<b>AGRICULTURE</b>			
Grains	73,389	4,996	2,516
Fruits & Vegetables	20,514	3,994	1,432
Sugar Cane	142,080	2,699	859
<b>LIVESTOCK</b>			
Animal Protein	73,616	11,608	4,596
Dairy	63,527	3,818	1,631
<b>TOTAL</b>	<b>373,126</b>	<b>\$27,115</b>	<b>\$11,034</b>

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## General credit policies / client profile

- ❖ At the very beginning of the process we follow some policies. There are some “musts”, as the client´s profile:
  1. Moral solvency (character)
  2. Economic soundness (capacity)
  3. Participate in agriculture, related business, and/or in rural areas
  4. Use of adequate technology
  5. At least three years of experience in his main source of income, five years if it is rural financing
  6. Located in irrigated areas or in recognized rainfed areas
  7. Markets well identified, clear destiny of his products
  8. Sound financial statements
  9. Solid production, sales, infraestructure, markets, projections (no matter the size)
  
- ❖ To determine if a client satisfies these criteria

**we must, personally, know him**

# General credit policies / industry profile

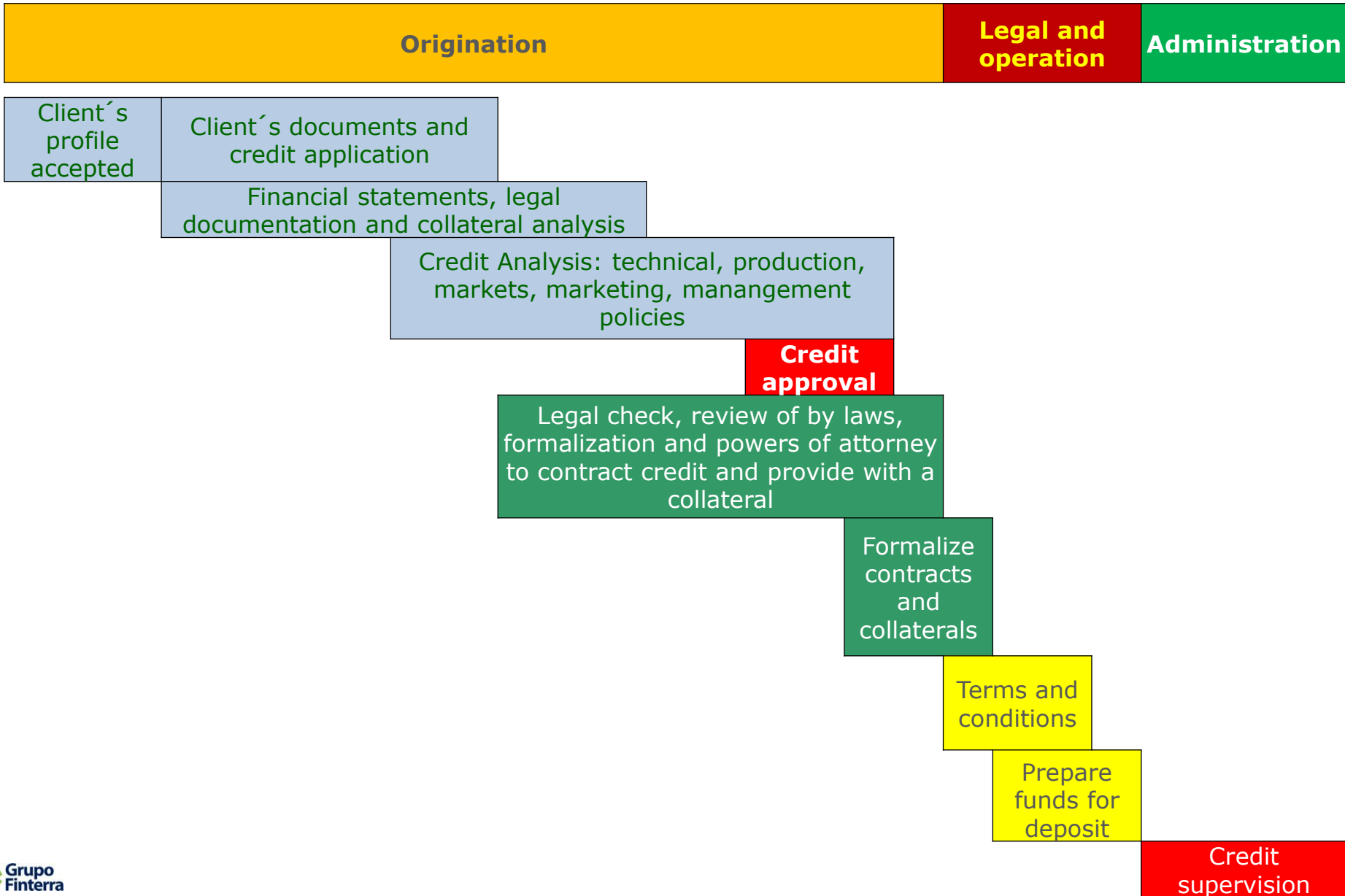
- ❖ Before entering in a particular industry we look, briefly look at (say Porter's model) competes:
  - Threat of new entrants
  - Threat of substitute products or services
  - Bargaining power of customers (buyers)
  - Bargaining power of suppliers
  - Intensity of competitive rivalry
  
- ❖ A new scope added at:
  1. Weather and weather related crops / livestock in the region
  2. Existing infrastructure
  3. Integration / existence of the value chain
  4. Social and environmental restrictions

# General credit policies / industry profile

- ❖ For Finterra there's no distinction in the risk assessment for agribusiness or individuals participating on them.
- ❖ As we want to build strong and long lasting relationships we see that all the credit solicitors are equal, regardless of:
  - Loan size
  - Value chain
  - Purpose of the loan (working capital, investment)
  - Domestic (local, regional, national) or foreign market
  - State of the country
  - Technology
- ❖ Documentation may change depending on:
  1. Type of organization
  2. Land tenure
  3. Collaterals (mortgages, certificates of deposit, endorsements)

# Credit process

❖ Our credit process is not different than the one used by commercial banks:



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# Expert risk assessment

- ❖ Before we analyze a credit application our Lending Officers must:
  - ✓ Have a clear idea of the client 's CHARACTER
  - ✓ Know the CAPACITIES of the client, not the potential (we look at the past, not to the future)
  - ✓ Identify the CAPITAL he has to invest in his own company or in the new project.
  - ✓ Request a sound COLLATERAL as a second way to recover the loan
  - ✓ Propose the CONDITIONS to formalize the credit
  
- ❖ The Lending Officers we hire must have:
  - ✓ Experience in AG financing (at least 5 years)
  - ✓ Previous banking experience
  - ✓ An understanding of agricultural activities in the region
  - ✓ Have an Ag or biological University background
  
  - ✓ And they are be locally hired

# Expert risk assessment

- ❖ Finterra must identify in a potential client:
  - ✓ Local relationships and reputation
  - ✓ Know the location, have an idea of the natural conditions
  - ✓ Actual or potential markets
  - ✓ Experience
  - ✓ Presence
  - ✓ Changes in conditions, investments,
  
- ❖ And collect all the documents we must collect (national regulation)
  - ✓ Birth Certificate / CURP
  - ✓ Identification
  - ✓ Proof of residence
  - ✓ Fiscal (Revenue service) information
  - ✓ Financial statements
  - ✓ Authorization to check credit records
  - ✓ By laws
  - ✓ Marriage certificate
  - ✓ Ownership deed (mortgages)
  - ✓ Water concession
  
- ❖ Annual credit reviews must comment on the topics above

# Expert risk assessment pre-qualifying our clients

- ❖ Once we check that the client's profile fulfill with policies, using a minimum documentation we pre-qualify the client, with this we measure, somehow his CHARACTER.
  - ✓ [Precalificación Inglés Finterra -1.xlsx](#)
- ❖ Now let's see the working version:
  - ✓ [Precalificacion FinTerra \(v5 1\).xls](#)
- ❖ Result: a grade from 0 to 10, where 7.5 is the minimum to approve

# Risk rating model

- ❖ To formalize a credit operation and before the credit approved we determine a risk grade for each client.
- ❖ The purpose of this is to determine
  - ✓ The probability of default
  - ✓ Expected losses
- ❖ To have a sound credit portfolio and to help Finterra have a clear balance sheet, we measure the actual credit risk for each client.
- ❖ We use a formal Credit Risk Rating Model
- ❖ There 's some previous work before using this tool.
  - ✓ Risk Area of Finterra determines:
    - Rank the technological levels
    - Legal risk of the State of the country where the farmer lives
    - Industry 's risk rating
    - Determine Social and Environmental risk rates for each industry

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- ❖ To have a sound credit portfolio and to help Finterra have a clear balance sheet, we measure the actual credit risk for each client.
- ❖ We use a Credit Risk Rating Model (mandatory for the banks, not for the non-banks banks)
- ❖ With this tool Finterra defines the provisions to be created for each loan:
  - ✓ [Calificación de riesgo Finterra Inglés.xlsx](#)
- ❖ Now look at the working model
  - ✓ [Calificación de riesgo Finterra \(v 4 0\).xls](#)

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# Conclusions

- ❖ No tool can:
  - ✓ change the CHARACTER of the client
  - ✓ Improve his CAPACITIES
  - ✓ Increase or provide the CAPITAL needed for the operation
  - ✓ Ensure that a COLLATERAL will force the client to repay the loan
  - ✓ Define the CONDITIONS for the perfect credit
  
- ❖ There 's nothing better than:
  - ✓ Knowing what we 're doing (or what we 're trying to do) as a lender
  - ✓ Knowing the growing or producing conditions of the client and understanding what can be grown or risen.
  - ✓ Keeping a close look at the use of the credit, and
  
  - ✓ **Personally knowing and understanding the client**